No. 18449

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

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WESTERN CREDIT COMPANY, INC.,
A corporation,

Appellant and Petitioner,

-vs-

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

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APPELLANT'S REPLY BRIEF

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CITATION OF AUTHORITY

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actual purport of the testimony. For this reason, it might be well to point out that the sole evidence in the case consists of the stipulation between the parties, plus the testimony of Joe L. Irwin, the manager of petitioner, and Louis A. Lanouette. Neither witness was contradicted in any way and their testimony stands completely unopposed in the record. This being so, we should be governed by the general rule of evidence which is set forth at 32 C.J.S., page 1089, as follows:

> "Uncontroverted evidence should ordinarily be taken as true, and uncontradicted evidence which is not improbable or unreasonable cannot be disregarded, even if it comes fron an interested witness, and, unless shown to be untrustworthy, is conclusive; but evidence not directly contradicted is not necessarily binding on the triers of fact, and may under proper circumstances be given no weight, as where it is inherently improbable or unreasonable, self contradictory, or inconsistent with facts or circumstances in evidence."

No attack has been made upon the credibility of either of these witnesses, there does not appear to be anything inherently improbable or unreasonable in any of the testimony, it is not self-contradictory, and it is not inconsistent with other facts or circumstances in the evidence. Hence, we should take the testimony as true. In addition to this, we should take the

testimony as it was meant to be taken by the witnesses. We should not attempt to put words in their mouths, nor should we twist the meaning of their statements, nor should we do anything other than attempt to interpret their testimony as they meant it to be interpreted and as, to the best of their ability, they were able to put it into words.

As an example of the foregoing, we refer to the note at the bottom of page 18 of respondent's brief, in which it is said that "taxpayer's assertion (Br.14) that its borrowers 'understood' that the contract charges were not imposed "for the use of money" is unsupported in the record (R.58,73,104). That the borrowers were perhaps <u>told</u> that the charges were necessary to cover their lender's expenses of determining the risk factor in making loans to them is obviously of no significance here." This footnote is not quite in accordance with the testimony. On page 73 of the transcript we find the following:

> "Q Was it explained to him that it was for the use of the money or as the cost of setting up the loan?
>
> A It was explained as the cost of setting up the loan.
>
> Q And each borrower understood that at the time he took out the loan, is that right?
>
> A That's right."

Obviously, the pure purport of the testimony is that prior to any loan being granted, the nature of the contract charge was carefully explained to each prospective borrower, the prospective borrower understood what the situation was, and that he accepted the terms and conditions by his execution of the note. If a fine distinction is to be made involving the use of the word "understood" and the contention made that the witness could not testify as to what was in another's mind, the objection would better have been raised at the time, and not now. We think it will not do to contend at this stage of the proceedings that no element of agreement was reached between the borrower and the lender as to the nature of the charges involved in this case simply because the term "understood" might refer to someone else's state of mind. The testimony, taken as a whole, clearly reveals that each individual borrower and the witness Irwin discussed the nature of this contract charge, and that it was acceptable to the borrower, as a charge for services to be rendered the borrower, and not as additional interest.

In similar vein, we note the breakdown on page 9, of appellant's records of payments made by borrowers into six categories, and the later statement on the same page, that neither the contract charge, the carrying

charge, or any other charge was specifically allocated on any of the taxpayer's books and records to any particular expense of the business. The latter statement omits the fact that the separation of the contract charge from the carrying charge was actually made on the taxpayer's records at the inception of the loan, and the worksheets carrying such breakdown were made a permanent part of taxpayer's records so that the precise amount charged on each loan as a contract charge could always be determined. It seems to us that the mere fact that petitioner did not carry forward the breakdown through the rest of his records is completely immaterial, unless it can be said that this whole question is simply one of bookkeeping, and nothing else. When payments were made to petitioner, the fact that the payments were broken down in a different fashion than they were originally set up means only that petitioner's records are kept in this fashion and nothing else. If because of petitioner's bookkeeping system, he was completely unable to segregate his interest charges from his charges for services rendered, we would have a different situation similar to that contained in the Noteman case. But we do not have this condition, because the worksheets, part of the permanent records with reference to each loan, are available to determine how much was charged

for services, and how much was charged for interest.

In a footnote on page 13, respondent also claims that certain contentions of petitioner have been abandoned. This is not so. None of the contentions mentioned have been abandoned either in the tax court or now. The contentions, if indeed they are such and not actually statements of fact, are not of course decisive of the issue, and are advanced as background information only. Hence they are not belabored in argument, and will not be extensively treated here. It seemed to us in the court below, and it seems to us now, that these facts give rise to certain equitable considerations which should form the threshold over which we advance to a consideration of the technical legal questions involved in the present appeal, and they should not be completely ignored simply because they are not in themselves determinative of the issue.

Similarly, at the top of page 19 of respondent's brief it is asserted that "the contract charges were not allocated for specific services or expenses and, more important, were not shown to have been used to cover the cost of any specified services rendered for the benefit of the borrower". Perhaps our difference with respondent here is more in the use of language than anything else, but it does seem to us that the

record could scarcely be more clear to the effect that the contract charges were actually allocated for specific services rendered, and for no other purpose, and were actually used to cover the cost of these services. It may be that in each individual instance the contract charge was a lump sum charge rather than a precise breakdown of the actual, out-of-pocket costs that would be incurred in connection with that specific loan, but this is not to say that the amount of the contract charge was not specifically allocated to the rendering of these services. In fact, the testimony is that in most cases the contract charge was insufficient to cover the cost of the investigation and hence the cost of the services rendered. In some cases it is possible that the contract charge exceeded the precise costs of the investigation and services in that particular case, but the testimony is also to the effect that the contract charges in toto did not cover the cost of the investigations and services in toto and that part of these costs had to be born by the carrying charge.

This is the true purport of the testimony of the witnesses if their testimony is to be interpreted as they intended it to be interpreted and as they attempted to express it.

In a similar vein is the statement on page 22

of respondent's brief that "it is clear that the contract charges had to cover the cost of investigations of prospective loans never made (a general overhead expense) at least as much as did the carrying charges, which were allegedly reserved for costs incurred after the loan was set up". The clarity that appears to respondent is not vouchsafed to us. The nature of the contract charge was the subject of testimony throughout the record. Some of this testimony was not referred to in respondent's brief, following the above quotation.

For instance on page 59 of the transcript, we find the following answer made by Mr. Irwin

> "A. The contract charge was solely the cost of the initial setting up of the loan, the cost of investigating the several things that we have to do; the customer himself, sofar as his habits, paying habits, go; the collateral; all of the very many things that we have to do in order to set up a loan in the first place, that is from the time of taking the application until it is finally set up as a loan in your file."

From this point on Mr. Irwin testified in response to many questions about the nature of this charge. The general tenor of his testimony, starting from the foregoing as the initial point, is that the contract charge is just what he said: "<u>solely</u> the cost of the initial setting up of the loan". This testimony is not contradicted by any other witness, nor is it

Workingmen's. We are unable to find so many factual differences between the present case and the Workingmen's case as to justify such cavalier treatment. In fact, it seems to us that the cases are on all fours, or nearly so.

It is our feeling that the Noteman case, standing alone, cannot be taken as authority for the posture assumed by the government in this case. The Noteman case and the Workingmen's case, having been both decided by the same judge and the same court, with reference to the same law, must be considered together in order for the actual meaning of the Noteman case to be ascertained. It will not do to take language from the Noteman case and apply it indiscriminately to subsequent cases, without reference to the fact that the very language being so applied was later modified and explained by the Workingmen's case. In effect, the latter case says to the world: "What we meant in that Noteman case was this, and we should not be interpreted as having said that, even though the language might seem to say the latter."

By following this course, and by selecting language from the Noteman case, the government arrives at what amounts to the following three basic contentions:

1. That "cost to the borrower" and "interest"

respondent that the contract charge and the carrying charge, which together account for more than 80 per cent of taxpayer's income, were imposed by the lender in place of a formal interest charge and the assumption is then made that because the borrower regularly paid these charges they are therefore within the definition of the term interest.

This is to be read in connection with the language on page 15 of the brief, in which after conceding that interest is the amount which one has contracted to pay for the use of borrowed money, respondent goes on to note that a borrower from a small loan company is basically interested only in obtaining the use of lender's money, and is willing to pay what is required to obtain such use. Apparently, then, any sum whatsoever, paid by a borrower to a small loan company is interest, whether such payment is in actuality for the use of money or not. Such a conclusion can be reached only by completely ignoring the definition of interest which has already been established, namely that it is the amount paid for the use of money. If it is an amount paid for something else, then it is not interest. Even the Noteman case, as restricted as it is, concedes that a small loan company in particular, or any lender in general, may collect sums of money

appraiser's fee for appraising property which is offered as security, or a lawyer's fee for searching a title. In the Workingmen's case the court then points out that services of this nature, - and note the term "of this nature", - can be rendered by the lender instead of a third person, but this fact does not convert the nature of the payment into interest.

In this case, too, the taxpayer on the witness stand presented a broad range of items, some of which occur in some loans, and some of which occur in others, but all of which are included in the contract charge, which according to his testimony, was solely the cost of setting up the loan on the books. How these payments for services rendered get translated into interest is merely part of the legerdemain of the language used by respondent in its brief.

We noted above that respondent seems to argue that any cost to the borrower from a small loan company must of necessity be included within the term interest. No reported case makes any such a holding as this, and yet respondent argues that all of the items referred to by petitioner as services to the borrower are not such in fact but in reality they are part of the overhead of the small loan business. The argument here is that since the small loan business is one involving a high

degree of risk, and since a higher rate of interest would therefore be justifiable, it must necessarily follow that any payment made to a small loan company will be classified as interest regardless of whether the parties agreed otherwise or not. Such a conclusion can be found neither in the testimony nor in the reported decisions.

The extremes to which the government goes is illustrated by the argument with reference to the distinction between benefit to the borrower and benefit to the lender. It would appear, from the arguments contained in page 24 of the brief, that since the borrowers are required to submit to these charges even though they derived no benefit from the expenditure thereof by the taxpayer, they are therefore interest. It is true that in the Noteman case the court observed that the taxpayer there enumerated certain charges which seemed to the court to be for the benefit of the lender rather than to the borrower, and therefore held that the only real consideration which the ordinary small borrower receives is the use of money. But this decision was later modified and explained in the Workingmen's case and we certainly cannot go to the length of saying that if any benefit at all from an expenditure accrues to the lender, the expenditure must be classed as interes

The degree of risk in the business is not relevant to the question at hand because our search here is for the essential nature of a charge, i.e. whether it is an interest charge, or whether it is a charge for something else.

In this connection, we are interested also in the offhand dismissal by the respondent of the Elk Discount case. The statement is that since Elk Discount Corporation was not in the business of lending money, and since the buyers of automobiles were not borrowing money from the taxpayer, the case is not in point. In other words, what once was really interest, changes to something else if the note is assigned to a person who does not actually lend the money. It is clear in the Elk Discount case that when the purchaser of the automobile signed the contract, the amount of money covered by the contract included a certain sum for interest. It is also clear, if we are to look at the essence of a thing, and not just the superficial details, that the amount paid by the purchaser of the automobile, even when paid to the Elk Discount Corporation, still included an element of interest. The court held, however, that this was not personal holding company income. Why? Because the taxpayer did not receive it as interest, but as payments being made on

paper which it had purchased from the dealer in automobiles. The essential point, it seems to us, is that the payment is not to be identified only by the fact that it is paid by a borrower, but also by the circumstances under which it is received by the recipient.

In passing, it appears that respondent, by virtue of its selection of the particular quotation to utilize from the Workingmen's Loan case and its use of italics in the quotation, is making some point that in the Workingmen's case the charges were paid in advance, while in the present case they were added to the face of the note. In this connection it must be remembered that petitioner was operating in the state of Montana. The Workingmen's case is not clear as to whether the payment in advance referred to was accomplished by the actual passage of cash across the table or in some other manner, but this is immaterial in the present case, because in Montana, the rule of law is that the payment of antecedent debts by the giving of the promissory note discharges the antecedent debt, and constitutes a payment thereof. This is perhaps set out as well, in general, at 70 C.J.S., page 231, as anywhere:

"A bill of exchange or promissory note executed and delivered by a debtor to his creditor constitutes a payment thereof, and discharges the debt when it is so agreed, understood, or intended by the parties, but some authorities limit the rule to an express agreement, and authorities which consider the rule applicable to an implied agreement insist that the implication be clear."

The various states are in some disagreement on this point, as is indicated by the preceding text treatment of the subject, commencing on page 229 of Volume 70, C.J.S. However, the state of Montana is one which falls within the rule cited in the quotation above, as is indicated by the two Montana cases: Yale Oil Corporation vs. Sedlacek, 43 P2d. 887, 99 Mont. 441, and Gallaher vs. Thielbar Realties, 18 P2d. 701, 93 Mont. 421. It follows that in this case also, the payment for these charges was collected in advance, by being added to the amount of the principal of the note.

We note also the curious treatment afforded the case of Virginia Loan and Thrift Company vs. Commissioner, 2 T.C.M., 27, on page 23 of respondent's brief, in which the statement was made that an investigation fee was held not excludable from interest because it was not related to a particular investigation.

In fact in the Virginia Loan case, no investigation at all was made, and the fee was collected for a non-existent investigation, as is indicated by the quotation from the case contained in our opening brief.

Finally, it appears to us that all of the services rendered which were covered by the contract charge in this case were services which in the light of the reported decisions, and particularly the Workingmen's decision, were services for which a separate charge could reasonably be made without the same being classified as interest. The amount of the contract charge was actually segregated by the taxpayer on its records, and is capable of precise ascertainment. The nature of the charge is such that without it, the borrower could not have qualified for a loan at all, and is therefore of primary benefit to the borrower, since it puts him in position to obtain a loan for which he will then have to pay another charge for the use of the money, which latter charge is interest. There is no reason, either in the reported cases or in the statutes, why petitioner must break down his contract charge any further than he has, notwithstanding the apparent contention of the government that having once segregated the charge for services rendered during the initial investigation, including the preparation of

necessary papers, the rendering of services in connection with automobile titles, notarial services, inspection and identification of collateral, preparing financial statements, paying off other loans, obtaining receipts therefor, preparing satisfactions of other chattel mortgages, and so on, through a long list of services detailed by the witnesses for petitioner, we must now go still further, and attempt to tie each element of the contract charge to the particular loan in which it was made. Such a requirement is not contained in any of the reported cases, and would be impossible of attainment. Such a holding is the equivalent of saying that every payment made by a borrower to a lender, operating a small loan company, is interest under the Personal Holding Company Act. Petitioner in this case has brought himself squarely within the rule announced by the combination of the Noteman case and the Workingmen's case, and in justice and equity should not be held responsible for the confiscatory taxes imposed by the Personal Holding Company Tax, and designed principally for the purpose of preventing the evasion of taxation by the use of the "incorporated pocketbook".

Respectfully submitted this 12th day of June, 1963.

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By Randall Swanberg
OF COUNSEL

CERTIFICATE

I certify that, in connection with the preparation of this reply brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing reply brief is in full compliance with those rules.

Randall Sunderey

ATTORNEY

AFFIDAVIT OF MAILING

STATE OF MONTANA)
: ss.
County of Cascade)

GLORIA SKULRUD, being first duly sworn upon her oath deposes and says: that she is and was on the 12 day of June, 1963, over the age of eighteen years and not a part to the within action; that there is a regular communication of mail between Great Falls, Montana, and Washington, D. C. in which latter place Mr. Louis F. Oberdorfer has and maintains his offices; that there is a regular communication of mail between Great Falls, Montana, and Washington, D. C. in which latter place Mr. Crane C. Hauser also has and maintains his offices; that on the 12 day of June, 1963, she deposited in the United States mails at Great Falls, Montana, true and correct copies of the Appellant's Reply Brief in a postage prepaid envelope securely bound to:

Mr. Louis F. Oberdorfer
Ass't Attorney General
Tax Division
U.S. Department of Justice
Washington 25, D. C.

Mr. Crane C. Hauser
Chief Counsel
U.S. Treasury Dept.
Internal Revenue Service
Washington 25, D.C.

Gloria Skulrud

SUBSCRIBED AND SWORN to before me this 12 day of June, 1963.

Philip Stroope

Notary Public for the State of Mont.
Residing at Great Falls, Montana.
My Commission expires: 9/2/64